



Legislative Audit Division

Performance Audit Summary

Pay Plan 20

November 2006

Introduction

The 1997 Legislature passed House Bill 13 directing the Department of Administration to develop an alternative classification and pay system for state employees. This alternative system is Pay Plan 20.

Our audit objectives were to:

- Determine the degree of implementation.
- Determine if desired outcomes are being achieved.
- Determine the extent of legislative guidance and related management controls over its administration.
- Determine if pay rates established by the Department of Administration reflect market.

Background

Pay Plan 20 is referred to as the state's broadband pay plan (broadbanding). Broadbanding is a method of defining occupations and associated pay ranges to enable more flexibility in pay administration. Broadbanding consolidated the state's 25 grade pay matrix from Pay Plan 60 into nine pay bands. Under Pay Plan 20, agency management has flexibility to award pay increases according to their own pay policies and within agency approved operating plans. There are several types of pay adjustments available including market-based, performance-based, results-based, situational pay, strategic pay, and bonus pay. These pay adjustment types are suggested through department guidelines, but not mandated by statute, rule, or policy.

While Pay Plan 20 is called an alternative pay plan, the majority of state agencies are using it. Flexibility in pay administration is a significant change, and this flexibility has an impact on the state's compensation philosophy. First, the structure of Pay Plan 20 is based on comparable market salaries, and most agencies have focused on market-based pay. The second part of pay administration in Pay Plan 20 is performance-based pay. The performance element of Pay Plan 20 has not been fully realized.

Market Analysis

The Department of Administration is responsible for administering Pay Plan 20. One of the main activities conducted under this responsibility is market analysis. Market analysis is the collection and analysis of salary data

from other employers for similar jobs. The results of the analysis are used to establish market pay rates for specific occupations. Overall, the department's market analysis process follows common industry practices. However, we identified several areas where improvements could be made to strengthen the market analysis process.

Discounting Survey Data

In order to approximate the relationship of Montana salaries to national salaries, the department's market analysis process includes an adjustment to national survey data. The department established a 15 percent discount factor using the relationship of Montana to the U.S. median wage.

Documentation of the methodology used by the department does not clearly indicate this discount provides the best estimate. The department currently uses a general discount factor of 15 percent for all occupations, but median rankings are also available for individual occupations. If the department used the factor associated with each occupation rather than a general discount factor, it could provide a more practical market rate for each occupation. ***We believe the department should re-evaluate and document its discounting methodology to better reflect market.***

Competitive Labor Market

For compensation, the term market refers to the collective group of employers that compete for employees. Statute, while limited for the alternative pay plan, does indicate pay is to be established based on the relevant labor market. However, Montana's relevant labor market is not defined in rule or policy.

The department developed its process without specifically defining market. Survey data that is readily available, commonly used, and lower in cost to retrieve is used to set market rates. More specific survey data is available, which may be more relevant to Montana's competitive labor market. ***The department should identify this relevant labor market and develop a definition based on current practices and input from state agency personnel.***

Criteria to Guide the Process

Department staff regularly make decisions regarding use of salary survey data for calculating market rates. There are no set criteria on when to use survey data and when to

eliminate it from calculations. Division personnel set market rates for over 400 occupations, so it is important to have formal guidelines to help ensure consistent decision-making in calculating market rates.

While some judgment needs to be applied, formal guidelines are needed. ***In order to facilitate consistency between analysts, as well as facilitate consistency from year to year, the department should develop formal guidelines for decision-making. The department could incorporate guidelines into current analysis tools for use during group discussions and finalization of markets.***

Market Analysis by Other Entities

While most agencies adopt market rates established by the department, there are some occupations in which market rates are established by other state agencies. For example, one agency chooses not to adopt department market rates, and instead establishes its own rates. There is no policy regarding how market rates should be established for unique occupations, and how the process should be conducted when this occurs.

According to statute, it is the intent of the legislature that compensation plans for state employees be based on an analysis of the labor market as provided by the department. ***In order to fully implement the intent of the law, the department should be providing guidance and approving the market analysis for all occupations.***

The Compensation System Is Changing

The department plans to seek legislation to establish Pay Plan 20 as the State of Montana's main compensation system and move all employees to the new pay plan by July 1, 2007. In order to make an informed decision, there are some key questions the Legislature should consider during its discussions of Pay Plan 20.

Pay Plan Variations

Variations among state agencies have created differences in pay. The department sets a minimum, market, and maximum pay rate for each occupation. However, employee pay is up to the discretion of agency management. This flexibility allows managers to use pay to recruit, retain, and reward employees for performance, competencies, and achievements. With no specific guidance, and variations between agencies in available funding, individual employees in Pay Plan 20, hired for the same occupation but in different agencies, can and do get paid varying amounts within occupational pay ranges. Excluding any pay for performance components, the likelihood of pay inequities is greater. These differences in pay result in competition between agencies for employees with the same skills.

Cultural Change

The concept of broadbanding is a major change in compensation philosophy and organizational culture for the state. Managers have more flexibility in setting pay based on market trends and performance. Employees have more flexibility in individual development and career progression. From an organizational standpoint, the change can be characterized as a move from one of entitlement (everyone gets a pay increase) to one based on performance (employees who perform get increases).

Performance-based pay is a main component of broadbanding. While Montana's state agencies are not required to implement a performance-based pay component as part of Pay Plan 20, some have done so or have plans to implement this component in the future. ***By granting managers and supervisors more discretion to determine pay increases, pay for performance increases responsibility for supervision and implementation of performance measurement.***

Measuring Outcomes

The idea behind creation of the alternative pay plan was to address recruitment and retention issues by providing agency managers with tools to better meet individual agency needs. It has been more than five years since state agencies started transitioning to Pay Plan 20. However, there is no information available indicating whether the alternative pay plan is achieving desired outcomes.

Effective implementation should include an ongoing review of the system. There is no requirement to track and monitor recruitment and retention, employee productivity, or other aspects related to outcomes. As a result, each agency is left to its own devices on whether or not to monitor operations. In order to determine the impacts of Pay Plan 20, outcomes need to be tracked and monitored.

For a complete copy of the report (06P-06) or for further information contact the Legislative Audit Division at 406-444-3122; e-mail to lad@mt.gov; or check the web site at <http://leg.mt.gov/css/audit/>